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In The

Supreme Court of the United States

No. 893

I. L. Clayton, Commissioner of Revenue
of the State of North Carolina,
Appellant,

v.

United States of America,
Appellee.

On Appeal from the United States District Court
for the Eastern District of North Carolina

JURISDICTIONAL STATEMENT

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On Appeal from the United States District Court
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JURISDICTIONAL STATEMENT

Appellant appeals from the judgment of the United States District Court for the Eastern District of North Carolina entered on October 18, 1965, declaring a refund provision of the North Carolina Sales & Use Tax Act of North Carolina unconstitutional as being invidiously discriminatory against the United States and, therefore, in contravention of the 14th Amendment to the Constitution of the United States, and ordering a substantial refund to the United States, and submits this Statement to show that the Supreme Court of the United States has jurisdiction of the appeal and that a substantial question is presented. The case below was heard before a three-judge court pursuant to 28 U.S.C. § 2281.

OPINION BELOW

The opinion of the District Court for the Eastern District of North Carolina has not been reported. A copy of the opinion and Order of Judgment is attached hereto as Appendix A, and a copy of the decision of the Commissioner of

Revenue of North Carolina denying the Government's claim for refund and which gave rise to this case is attached hereto as Appendix B. The applicable Regulations of the North Carolina Department of Revenue are attached as Appendixes C, D and E.

JURISDICTION

This suit was brought (a) under 28 U.S.C. § 1345, being a civil action commenced by the United States, and (b) 28 U.S.C. §1331, the amount in controversy exceeding $10,000, exclusive of interest and costs, and the suit arose because of the invocation of the 14th Amendment to the Constitution of the United States. (The United States also relied on the provisions of the Constitution of North Carolina, but the lower court found it unnecessary to pass upon that aspect of the case since it based its decision on the 14th Amendment.) The three-judge court was assigned to hear the case because the Government was seeking to enjoin a sovereign state from the collection of taxes. Direct appeals to the United States Supreme Court in cases such as this are directly authorized by 28 U.S.C. § 1253.

QUESTION PRESENTED

Is a state sales and use tax statute which imposes a sales tax upon vendors of tangible personal property which enters into and becomes an integral part of a structure and which imposes a similar use tax upon such (contractors) users and which, when paid by contractors with the Federal Government, are not refunded to the Federal Government but which, according to North Carolina law (see "Statutes Involved," *infra*), are refunded to certain specified political subdivisions of the State of North Carolina when paid by contractors with such political subdivisions of the State "invidiously discriminatory" against the United States so as to be condemned by the 14th Amendment to the Constitution of the United States?

STATUTES INVOLVED

Since the North Carolina statutes involved in this case are

not too lengthy, they will be set out here, in pertinent parts, as follows:

North Carolina G. S. 105-164.4 (North Carolina General Statutes, Michie's Code, Vol. 2D, p. 404):

"§ 105-164.4. *Imposition of tax; retailer.*—There is hereby levied and imposed, in addition to all other taxes of every kind now imposed by law, a privilege or license tax upon every person who engages in the business of selling tangible personal property at retail, renting or furnishing tangible personal property or the renting and furnishing of rooms, lodgings and accommodations to transients, in this State, the same to be collected and the amount to be determined by the application of the following rates against gross sales and rentals, to wit:

(1) At the rate of three per cent (3%) of the sales price of each item or article of tangible personal property when sold at retail in this State, the tax to be computed on total net taxable sales as defined herein but for the purpose of computing the amount due the State each and every taxable retail sale, or retail sales upon which the tax has been collected, or the amount of tax actually collected, whichever be greater and whether or not erroneously collected, shall be included in the computation tax due the State . . ."

North Carolina G. S. 105-164.6 (North Carolina General Statutes, Michie's Code, Vol. 2D, pp. 410, 411).

"Part 3. Use Tax.

§ 105-164.6. *Imposition of tax.*—An excise tax is hereby levied and imposed on the storage, use or consumption in this State of tangible personal property purchased within and without this State for storage, use or consumption in this State, the same to be collected and the amount to be determined by the application of the following rates against the sales price, to wit:

(1) At the rate of three per cent (3%) of the cost price of each item or article of tangible personal property when the same is not sold but used, consumed, distributed or stored for use or consumption in this State; except that, whenever a rate of less than three per cent (3%) is applicable under the sales tax schedule set out in G. S. 105-164.4 to the sale at retail of an item or article of tangible personal property, the same rate shall be used in computing any use tax due under this subdivision.

(3) There is hereby levied and there shall be collected from every person, firm, or corporation, an excise tax of three per cent (3%) of the purchase price of all tangible personal property purchased or used which shall enter into or become a part of any building or other kind of structure in this State, including all materials, supplies, fixtures and equipment of every kind and description which shall be annexed thereto or in any manner become a part thereof. Provided, however, the taxes levied in this section shall be levied against the purchaser of the article named. If purchases of building materials that are not exempt from tax are made by a contractor there shall be joint liability for the tax against both contractor and owner, but the liability of the owner shall be satisfied if affidavit is required of the contractor, and furnished by him, before final settlement is made, showing that the tax herein levied has been paid in full."

North Carolina G. S. 105-164.13(17) (North Carolina General Statutes, Michie's Code, Vol. 2D, p. 417).

"Exempt Status Group.

(17) Sales which a state would be without power to tax under the limitations of the Constitution or laws of the United States or under the Constitution of this State."

North Carolina G. S. 105-164.14(c) (North Carolina General Statutes, Michie's Code, Vol. 2D, p. 420).

"(c) The Commissioner of Revenue shall make refunds annually to all counties and incorporated cities and towns in this State of sales and use taxes paid under this article by said counties and incorporated cities and towns on direct purchases of tangible personal property. Sales and use tax liability indirectly incurred by such counties, incorporated cities and towns in this State on building materials, supplies, fixtures and equipment which shall become a part of or annexed to any building or structure being erected, altered or repaired for such counties and incorporated cities and towns in this State shall be construed as sales or use tax liability incurred on direct purchases by such counties and incorporated cities and towns, and such counties and incorporated cities and towns may obtain refunds of such taxes indirectly paid. The refund provisions contained in this subsection shall not apply to any bodies, agencies or political subdivisions of the State not specifically named herein. In order to receive the refund herein provided for, counties and incorporated cities and towns in this State shall file a written request for said refund within six months of the close of the fiscal year of the counties and incorporated cities and towns seeking said refund, and such request for refund shall be substantiated by such records, receipts and information as the Commissioner may require. No refunds shall be made on applications not filed within the time allowed by this section and in such manner as the Commissioner may otherwise require. (1957, c. 1340, s. 5; 1961, c. 826, s. 2; 1963, cc. 169, 1134.)"

(Note: the 1965 General Assembly of North Carolina by c. 1006, S. L. 1965 extended the refund provisions to sanitary districts.)

Regulations Nos. 6, 42 and 48 of the North Carolina De-

partment of Revenue are attached hereto as Appendixes C, D and E.

STATEMENT

Prior to July 1, 1961, the North Carolina Sales & Use Tax Act (North Carolina G. S. 105-164.1 et seq., being Article 5 of Subchapter 1 of Chapter 105 of the North Carolina General Statutes), which imposed a general 3% sales and use tax on sales and the use, storage or consumption of tangible personal property, provided an exemption of direct sales to the Federal Government and to its agencies and instrumentalities and to the State of North Carolina, its political subdivisions and their agencies and instrumentalities. With regard to sales to contractors with the State of North Carolina and its political subdivisions, the North Carolina Act provided (G. S. 105-164.13(30)), in part:

> "Sales of building materials made directly to State and local governments in this State shall be exempted from the tax on building materials levied in this Act, and sales of building materials to contractors to be used in construction work for State or local governments shall be construed as direct sales."

No similar provision was made with respect to sales of building materials to contractors for construction work for the Federal Government.

The General Assembly of North Carolina of 1961 amended its Sales & Use Tax Act, effective as of July 1, 1961, to

(1) Retain the exemption of direct sales to the Federal Government, its agencies and instrumentalities.

(2) Repeal the exemption of direct sales to the State of North Carolina, its political subdivisions, their agencies and instrumentalities, and

(3) Provide a refund to North Carolina counties and

incorporated cities and towns of direct sales taxes paid and also of sales taxes paid by their contractors for the purchase or use of materials used in the construction or repair of structures of such political subdivisions of the State of North Carolina. This refund provision did not provide for refunds to the State of North Carolina, its agencies or instrumentalities, nor to the Federal Government for sales or use taxes paid by their contractors or their contractors' suppliers. The Department of the Army claimed that because North Carolina counties and incorporated cities and towns could, within the time set by statute, claim a refund of sales and use taxes paid by their contractors, and the Federal Government could not claim a similar refund of such taxes, the refund provisions of G. S. 105-164.14(c) "invidiously discriminated" against the Federal Government and was in contravention of the Constitution of North Carolina and particularly against the 14th Amendment to the Constitution of the United States. The Government, in apt time (if it were qualified for a refund), filed a claim with the North Carolina Commissioner of Revenue for a refund of sales and use taxes paid by contractors with the Department of the Army since July 1, 1961, which had been collected by North Carolina from such Government contractors. The claim for refund was refused by the North Carolina Commissioner of Revenue because he was not authorized by the North Carolina Sales & Use Tax Law to make such refunds. The United States Government thereupon brought this suit to:

(a) Recover sales and use taxes paid by contractors with the Department of the Army to the State of North Carolina since July 1, 1961,

(b) Recover sales and use taxes paid by contractors with any other branch or instrumentality of the Federal Government to the State of

North Carolina since July 1, 1961, although claims for such refunds had never been made, and

(c) Restrain and enjoin North Carolina from collecting any further sales or use taxes from contractors with the Federal Government or its agencies or instrumentalities or from the suppliers of such contractors.

The judgment of the lower court, which is set out in full herein, in effect declared:

(a) The taxing provisions of the North Carolina Act did not discriminate against contractors with the Federal Government or their suppliers and, therefore, the taxing provisions of the North Carolina Act, insofar as they affected the Federal Government or those with whom it dealt, *i.e.*, its contractors and their suppliers, were non-discriminatory and did not violate the 14th Amendment, upon which the decision was finally based.

(b) It found that the refund provision of the North Carolina Act, N. C. G. S. 105-164.14(c), which allowed refunds of sales and use taxes paid by counties and incorporated cities and towns of the State of North Carolina to their contractors, but not to the Federal Government (nor to the State itself, nor any other types of its political subdivisions) "invidiously discriminated" against the United States and was, therefore, in contravention of the 14th Amendment and, it must necessarily follow, void. However, the lower court did not strike down what it conceived to be an offending and discriminatory provision. Instead, the lower court legislated: it rewrote the refunds statute (N. C. G. S. 105-164.14(c)) to include "the United States of America, its agencies and instrumentalities."

(c) Although the lower court stated that it would not substitute a discrimination against the United States in favor of one in favor of the United States, so that the United States and its various agencies and instrumentalities must file claims for refunds within the time allowed for filing refund claims by North Carolina counties and incorporated North Carolina cities and towns, and although the Department of the Army was the only United States Agency to file a claim within the time allowed for North Carolina counties and incorporated North Carolina cities and towns (and late claims for refunds filed by North Carolina counties and incorporated North Carolina cities and towns have been uniformly rejected), the lower court gave all other agencies and instrumentalities of the United States an indefinite period of time in which to file their claims for refund of North Carolina sales and use taxes included directly or indirectly in the accounts rendered by their contractors.

To summarize: the lower court decided that North Carolina's sales and use taxation of Federal contractors and their suppliers is *not* out of line with the Federal Constitution, but that the refund provision of N. C. G. S. 105-164.14(c) did offend against the 14th Amendment to the United States Constitution. Instead of striking down what it conceived to be an offensive section, it amended it. The taxing provisions were approved. The refund provisions were found wanting. If the refund provision was the real villain in the Act (which is by no means conceded), the lower court should have stricken it down. If a statute is unconstitutional, it should be stricken down, not judicially amended. If N. C. G. S. 105-164.14 (c) was stricken down, the action of the lower court would not:

(a) Benefit the United States or those with whom it deals.

(b) Work a detriment to the State of North Carolina or its political subdivisions.

(c) Prevent the State of North Carolina from providing a grant-in-aid unrelated to the Sales & Use Tax Act but providing somewhat the equivalent to the sales and use tax paid to the contractors by the State's counties and incorporated cities and towns, in aid of their capital improvements programs. The lower court's opinion practically concedes that this (the substance of the situation) could be constitutionally accomplished by a change in the statutes. This is indeed looking at form rather than substance.

THE QUESTION IS SUBSTANTIAL

(1) The Federal Government is seeking to have declared, as contrary to the 14th Amendment to the Constitution of the United States, a provision in the Sales & Use Tax Law of the State of North Carolina which allows refunds to the counties and incorporated cities and towns of North Carolina, void.

(2) The district three-judge court so ruled.

(3) This is not only contrary to constitutional law as has been heretofore and will be hereinafter illustrated, but

(4) Is not sustained by any previous United States Supreme Court decision, nor has the question involved in this case been heretofore presented to this Court.

(5) The immediate loss of revenue to North Carolina will amount to some $2,000,000.00 per year, retroactive to July 1, 1961, if the judgment of the District Court is sustained.

(6) The decision of the District Court unnecessarily interferes with the fiscal policy of the State of North Carolina with regard to its financial assistance to its counties and municipalities, which policy is partly carried out by the contested refund provision of the North Carolina Sales & Use Tax Act (Article V of Chapter 105 of the North Carolina General Statutes, particiularly N. C. G. S. 105-164.14(c)). This policy of financially assisting the State's political sub-

divisions has long been carried out by provisions of North Carolina laws which:

(a) Allow the counties to levy the entire constitutional limitation of 20¢ on the $100.00 valuation of real and tangible personal property for their general funds although the Constitution of North Carolina (Article V, Section 6) allows the State to levy 5¢ of the constitutional 20¢ limitation, thereby releasing all of its potential revenue from ad valorem taxes to its counties.

(b) Turn over all of the proceeds of tax on intangibles, less costs of collection, to the State's counties and municipalities.

(c) Distribute a portion of the State's excise tax on beer and wine to its counties and municipalities.

(d) Distribute a portion of the franchise tax levied upon public utilities to its counties and municipalities.

(e) Distribute a portion of the gasoline tax levied by the State to its municipalities to aid them in the paving and maintenance of their streets, and

(f) Provide many grants-in-aid or matching funds for such local matters and functions as public health, welfare, aid to dependent children, and many other projects in many of which the Federal Government itself participates.

None of this State's financial aids to its political subdivisions have ever been thought of as being prejudicial to the United States for the reason that the United States did not get a similar distribution or grant-in-aid from the State of North Carolina. The grant-in-aid afforded the State's counties and municipalities by N. C. G. S. 105-164.14(c) (the sales tax refund provision) is of the same stripe and substance as the above alluded to financial assistance provided by the

State of North Carolina to its counties and municipalities and is no more prejudicial to or discriminatory against the Federal Government or those with whom it deals than is the refund provision of the North Carolina Sales & Use Tax Act (N. C. G. S. 105-164.14(c)) and *vice versa*. Form, and misinterpreted form at that, governed the decision of the District Court rather than the real and practical substance of the import and intent of the refund provision of the North Carolina Sales & Use Tax Act.

The decision of the District Court presents something of an anomaly. It upheld the State's right to collect sales and use taxes from contractors with the Federal Government as the State also collected such taxes from its own contractors and from contractors with its political subdivisions, and none of the contractors nor their suppliers could get a refund and the tax could have no influence on bidding. No discrimination here; so the *taxing* provisions of the Act were upheld to the extent that they affected the Federal Government. Only the *refund* provision was held to be void as contravening the 14th Amendment to the Constitution of the United States. Instead of striking down this "void" provision as unconstitutional, the District Court amended the "void" provision by making the United States a beneficiary of its provisions. It also enlarged upon those provisions by allowing departments, agencies and instrumentalities of the United States to file claims for refunds at a time which was untimely and which would have been denied by the State if filed at such a late date by the State's political subdivisions.

In conserving this Court's time in deciding whether this case deserves a hearing, perhaps the best method is to quote significant portions of the opinion and decision of the District Court as embodied in its Order of Judgment and to make comments thereon. Excerpts of the lower court's opinion, including footnotes, will be placed within quotation marks.

> "The plaintiff charges that the Act as drafted and administered invidiously discriminates against it,[4] (Footnote 4: The plaintiff's complaint also charges that the

Act infringes the immunity from state taxation which the federal government enjoys under the federal constitution. We think this contention is without merit for reasons and on the basis of the authority indicated in *United States v. Illinois Dep't of Revenue, infra* at 727-28. See particularly United States v. City of Detroit, 355 U.S. 466, 469-73 (1958).) resulting in a violation of both the Fourteenth Amendment to the United States Constitution and section 3 of article V of the North Carolina Constitution.[5] (Footnote 5: Because of our decision on the plaintiff's Fourteenth Amendment claim, we find it unnecessary to pass upon the state constitutional contention which has been advanced.) This is true, the United States asserts, because the Act and the regulations allow certain groups, specifically counties and incorporated cities and towns in North Carolina, to claim and collect from the defendant a refund of the taxes paid on certain purchases of tangible personal property[6] in North Carolina while a comparable procedure is not provided for the benefit of the United States and its agencies. After a careful consideration of the relevant authorities, we are of the opinion that the plaintiff's Fourteenth Amendment argument is a meritorious one and entitles it to summary judgment and injunctive relief."

Comment: There is no United States Supreme Court decision indicating that the plaintiff's 14th Amendment argument is meritorious. Although the District Court declared that the United States was entitled to a summary judgment and injunctive relief, the judgment itself denied the injunctive relief but instead, judicially amended the "void" statute. With the fundamental concept of a division of powers between the legislative, executive and judicial branches of government, both Federal and State, it seems a little strange that the judicial branch of the Federal Government should assume the legislative functions of a sovereign state.

"We note at the outset that this appears to be an appropriate case for judgment,[8] since the Government and the defendant seem in agreement on all material aspects

of this action except the claim that the Act invidiously discriminates against the United States. Interestingly enough, both parties have cited *Phillips Chem. Co. v. Dumas Independent School Dist.*, 361 U.S. 376 (1960), and *United States v. Illinois Dep't of Revenue*, 191 F Supp. 723 (N.D. Ill.), *vacated and remanded*, 368 U.S. 30 (1961), *on remand*, 202 F. Supp. 757, *aff'd per curiam*, 371 U.S. (1962), as support for their position. In view of this unusual unanimity of opinion regarding the controlling legal authority, some discussion of the decisions referred to above seems in order.

In the *Phillips* case, the plaintiff had leased from the federal government certain property in Texas on which it was engaging in the commercial manufacture of ammonia. The defendant assessed a tax measured by the estimated full value of the leased premises against the plaintiff, and a suit to enjoin the tax collection was commenced. It was conceded that had its lessor been the State of Texas or one of its political subdivisions, the plaintiff would have been subject to no property tax liability at all under Texas law. A divided Supreme Court of Texas upheld the assessment, but the United States Supreme Court, with Chief Justice Warren writing for a unanimous Court, reversed, characterizing the challenged Texas taxing provisions as a 'substantial and transparent . . . discrimination against the Government and its lessees.' 361 U.S. at 387. It is true, as the defendant here calls to our attention, that Chief Justice Warren in *Phillips* did not hold the Texas taxing provisions constitutionally infirm simply because lessees of the United States were taxed differently from lessees of the state or its political subdivisions. Instead he stated that 'the imposition of a heavier tax burden on lessees of federal property than is imposed on lessees of other exempt public property must be justified by significant differences between the two classes.' 361 U.S. at 383. After examining at some length the various considerations suggested in support of the different treatment to which the United States was subjected, he concluded that none of

them would justify the discrimination which was present.

> We note that one of the claims advanced and rejected in *Phillips* bears a striking resemblance to the primary justification for the North Carolina tax provisions suggested by the defendant in this case, namely that these provisions are simply the means the state has chosen to give the counties and incorporated cities and towns some financial assistance in providing the expanding services required by their rapidly increasing populations. While it is permissible and perhaps even laudatory for the State of North Carolina to assist financially its subordinate governmental units, in doing this it may not sacrifice the interests of the federal government.[10]"

Comment: The lower court stated: "Interestingly enough, both parties have cited *Phillips Chem. Co. v. Dumas Independent School Dist.*, 361 U.S. 376 (1960), and *United States v. Illinois Dep't of Revenue*, 191 F. Supp. 723 (N.C. Ill.), *vacated and remanded* 368 U.S. 30 (1961), *on remand*, 202 F. Supp. 757, *aff'd per curiam*, 371 U.S. 21 (1962), as support for their position. In view of this unusual unanimity of opinion regarding the controlling legal authority, some discussion of the decisions referred to above seems in order." The reason the State of North Carolina cited the above cases, which we believed would be the same cases which would be cited and relied upon by the Federal Government, was to show that those cases did not apply to or govern this case.

For example, the District Court relied principally on the *Phillips* case (361 U.S. 376 (1960)) which disclosed a flagrant and palpable infraction of the 14th Amendment. We have no quarrel with the *Phillips* case or the other cases cited and relied upon by the United States. We cited the same cases which we thought the United States would rely upon to show that the principles announced in those cases were good and acceptable as statements of constitutional law but did not apply to this case. For example, all of the cases upon which the United States relied were based upon (1) discrimination against those with whom the United States deals (the

Phillips case), and that element of discrimination is certainly lacking here, or (2) direct discrimination against the United States, which is also lacking in this case.

> "Second, even making the matter of the federal government's competitive disadvantage a crucial inquiry will not save the present tax, for it is not disputed that the *result* of the Act and regulations is that the United States is required to pay a larger *net cost* for the construction of a building than would be the case if the identical structure were being built for a North Carolina county or incorporated city or town. Upon closer examination, then, it becomes apparent that the uniform treatment which the contractors receive only serves to temporarily obscure the nonuniform treatment which exists for the real parties in interest, the governmental units which have construction work to contract. Since it is substance and not form in which we are interested in this case, it is proper that we consider not merely the surface appearance of equality but also the ultimate effect produced by the whole state tax structure.[12] Given this approach, we find this case indistinguishable in principle from *Phillips*."

Comment: Contrary to the Court's statement, it *is* disputed that the result of the Act and regulations as to the United States is required to pay a larger net cost for the construction of a building if an identical building were being built for a North Carolina county or incorporated city or town. The actual situation is that the State has joined with its counties and municipalities in constructing or repairing their buildings and the actual net effect is that if a county or a municipality should build a structure identical to one being built by the Federal Government upon the same plans and specifications and built by the same contractor and upon identical bids, the net cost to the Federal Government would exactly equal the net cost to the State and its political subdivisions.

The Court also stated: "Since it is substance and not form in which we are interested in this case, it is proper that we

consider not merely the surface appearance of equality but also the ultimate effect produced by the whole state tax structure.[12] Given the approach, we find this case indistinguishable in principle from *Phillips.*"

What the District Court did in this case was look through the form to the substance and back to the form again. This case is entirely distinguishable from the *Phillips* case because in the *Phillips* case, both the Federal Government and its lessees were being discriminated against in favor of the State of Texas and its lessees while in this case, neither the Federal contractors nor the Federal Government is being discriminated against in any manner when the net effect is properly analyzed.

It is submitted that the decision and judgment of the District Court in declaring void the refund provision of the North Carolina Sales & Use Tax Act and by making said refund provision applicable to the United States, its agencies and instrumentalities is in error. We believe that the question presented by this appeal is substantial and that it is of public importance.

Respectfully submitted,

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Appendix A

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA RALEIGH DIVISION

UNITED STATES OF AMERICA,	)	
	)	
Plaintiff	)	
	)	
v.	)	Civil No. 1487
	)	
I. L. CLAYTON, Successor to L. Sneed High, Successor to William A. Johnson, Commissioner of Revenue of the State of North Carolina,	)	
	)	
Defendant	)	

ORDER OF JUDGMENT

In this action instituted by the United States,[1] a permanent injunction has been sought restraining the enforcement of certain provisions of the North Carolina Sales and Use Tax Act[2] (hereinafter the Act) and the regulations issued thereunder on the ground that they are unconstitutional.[3] The plaintiff charges that the Act as drafted and administered invidiously discriminates against it,[4] resulting in a violation of both the Fourteenth Amendment to the United States Constitution and section 3 of article V of the North Carolina

[1] Our jurisdiction in this case is derived from 28 U.S.C.A. §§ 1331, 1345.

[2] *N. C. Gen. Stat.* § 105-164 (1965). The key provision, insofar as this proceeding is concerned, is § 105-164.14(c).

[3] Accordingly, this action has been heard before a panel consisting of three judges, as required by 28 U.S.C.A. § 2281.

[4] The plaintiff's complaint also charges that the Act infringes the immunity from state taxation which the federal government enjoys under the federal constitution. We think this contention is without merit for the reasons and on the basis of the authority indicated in *United States v. Illinois Dep't of Revenue*, *infra* at 727-28. See particularly United States v. City of Detroit, 355 U. S. 466, 469-73 (1958).

Constitution.[5] This is true, the United States asserts, because the Act and the regulations allow certain groups, specifically counties and incorporated cities and towns in North Carolina, to claim and collect from the defendant a refund of the taxes paid on certain purchases of tangible personal property[6] in North Carolina while a comparable procedure is not provided for the benefit of the United States and its agencies. After a careful consideration of the relevant authorities, we are of the opinion that the plaintiff's Fourteenth Amendment argument is a meritorious one and entitles it to summary judgment and injunctive relief.

The events leading to the commencement of this suit can be concisely stated. During the Government's fiscal year 1962, ending June 30, 1962, sales taxes were collected from contractors performing construction and repair contracts in North Carolina for the Department of the Army.[7] These taxes

[5] Because of our decision on the plaintiff's Fourteenth Amendment claim, we find it unnecessary to pass upon the state constitutional contention which has been advanced.

[6] The purchases in issue are indirect purchases, ones made by others but for the ultimate benefit of the local governmental units involved. These indirect purchases can be clearly illustrated by considering a situation where a contractor enters into contract with a county (or incorporated city or town) to construct or repair a building. The contractor makes the actual purchase of tangible personal property (*e.g.* building materials and supplies, fixtures, and equipment) and pays the state sales tax on the purchase to his supplier. The contractor then uses the personal property purchased to carry out his contract with the county, but the sales tax he paid is passed along to the county as part of the contractor's cost of the project (or it has been figured as an item of costs in the contractor's bid if the contract is for a flat figure rather than on a cost-plus basis). Thus both the ultimate benefit of the personal property purchased and the ultimate burden of the sales tax rest upon the county, and for that reason, the county is allowed to claim a refund for the sales taxes paid by the contractor.

No problem is presented regarding direct purchases of tangible personal property. Counties and incorporated cities and towns are entitled to claim a refund on these purchases, and direct purchases by the United States or its agencies are not subject to state taxation. 1 CCH State Tax Rep. (North Carolina) ¶¶ 60-203, 60-204.

Both direct and indirect personal property purchases by the State of North Carolina and all other political subdivisions except counties and incorporated cities and towns are subject to state taxation, and no tax refund is authorized by the relevant statutory provisions.

[7] The plaintiff claims that $65,833.24 in taxes was collected from these contractors during the 1962 fiscal year. The defendant asserts in its answer that the taxes collected were substantially less than the amount claimed by the plaintiff, but he offers no alternative collection figure. The documents filed with the court by the plaintiff make it clear that the projects for the Depart-

were imposed upon the purchase by the contractors of building materials, supplies, and fixtures and equipment utilized in the performance of the contracts previously mentioned, and all of these items either became a part of or were annexed to the structures being built or repaired for use by the plaintiff in the conduct of its governmental activities. The taxes were passed on by the contractors to the Government, and in due course, a timely application for a tax refund was filed. The refund application was subsequently denied by the defendant on the ground that he was without authority under the Act to grant it.

We note at the outset that this appears to be an appropriate case for summary judgment,[8] since the Government and the defendant seem in agreement on all material aspects of this action except the claim that the Act invidiously discriminates against the United States. Interestingly enough, both parties have cited *Phillips Chem. Co. v. Dumas Independent School Dist.*, 361 U.S. 376 (1960), and *United States v. Illinois Dep't of Revenue*, 191 F. Supp. 723 (N.D. Ill.), *vacated and remanded*, 368 U.S. 30 (1961), *on remand*, 202 F. Supp. 757, *aff'd per curiam*, 371 U.S. 21 (1962), as support for their position. In view of this unusual unanimity of opinion regarding the controlling legal authority, some discussion of the decisions referred to above seems in order.

In the *Phillips* case, the plaintiff had leased from the federal government certain property in Texas on which it was engaging in the commercial manufacture of ammonia. The defendant assessed a tax measured by the estimated full value of the leased premises against the plaintiff, and a suit to enjoin the tax collection was commenced. It was conceded that had its lessor been the State of Texas or one of its political subdivisions, the plaintiff would have been subject

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ment of the Army are only one example of the harm the United States claims to be suffering because of the allegedly unconstitutional discrimination; and if it is successful on the merits, the United States wants to recover the state taxes paid on all construction and repair work in North Carolina by and for all federal departments and agencies since July 1, 1961.

[8] Rule 56, Federal Rules of Civil Procedure.

to no property tax liability at all under Texas law. A divided Supreme Court of Texas upheld the assessment, but the United States Supreme Court, with Chief Justice Warren writing for a unanimous Court, reversed, characterizing the challenged Texas taxing provisions as a "substantial and transparent . . . discrimination against the Government and its lessees." 361 U.S. at 387. It is true, as the defendant here calls to our attention, that Chief Justice Warren in *Phillips* did not hold the Texas taxing provisions constitutionally infirm simply because lessees of the United States were taxed differently from lessees of the state or its political subdivisions. Instead he stated that "the imposition of a heavier tax burden on lessees of federal property than is imposed on lessees of other exempt public property must be justified by significant differences between the two classes." 361 U.S. at 383. After examining at some length the various considerations suggested in support of the different treatment to which the United States was subjected, he concluded that none of them would justify the discrimination which was present.

We note that one of the claims advanced and rejected in *Phillips*[9] bears a striking resemblance to the primary justification for the North Carolina tax provisions suggested by the defendant in this case, namely that these provisions are simply the means the state has chosen to give the counties and incorporated cities and towns some financial assistance in providing the expanding services required by their rapidly increasing populations. While it is permissible and perhaps even laudatory for the State of North Carolina to assist financially its subordinate governmental units, in doing this it may not sacrifice the interests of the federal government.[10]

[9] The claim there was that federal leasing of property had a more serious impact upon the finances and operations of local government than leasing by the state did, the implication being that while it could endure the exclusion from the tax lists of property utilized for commercial use but leased from the state or one of its political subdivisions, local government could not financially live with similar treatment for property leased from the federal government.

[10] It may be, as counsel for the defendant suggests, that the North Carolina legislature could amend the Act by deleting the authorization for all refunds and then make direct appropriations from the general revenue funds of the state to the counties and incorporated cities and towns, thereby accomplishing by direct grants the same financial assistance which now results from the re-

To paraphrase Chief Justice Warren's language in *Phillips*, it does not seem too much to require that a state treat the federal government as well as it treats itself or its political subdivisions.[11]

The preceding discussion should indicate that the defendant's efforts to distinguish the *Phillips* case leave us unpersuaded. It is argued that because of the operation of the Texas taxing provisions, the federal government there was placed at a competitive disadvantage in leasing its property, whereas here the controverted state taxes are imposed uniformly upon purchases made by all contractors, regardless of for whom they are building or repairing structures in North Carolina. We make two observations about this argument. First, there is no suggestion in the *Phillips* opinion that the Court decided that case as it did either solely or predominantly because of any competitive disadvantage considerations; rather, it appears that the Texas tax was overturned because it discriminated without justification against the United States. Second, even making the matter of the federal government's competitive disadvantage a crucial inquiry will not save the present tax, for it is not disputed that the *result* of the Act and regulations is that the United States is required to pay a larger *net cost* for the construction of a building than would be the case if the identical structure were being built for a North Carolina county or incorporated city or town. Upon closer examination, then, it becomes apparent that the uniform treatment which the contractors receive only serves to temporarily obscure the nonuniform treatment which exists for the real parties in interest, the governmental units which have construction work to contract. Since it is substance and not form in which we are

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fund procedure. The situation hypothesized by counsel, however, is not the one we are now considering, and we are content to limit our decision to the issues presently before us. Moreover, unconstitutional discrimination in state statutes can always be eliminated by deleting the discriminatory provisions from the statute, and, quite frequently the same result accomplished by the discriminatory procedures could be effected by resorting to alternative procedures which are free from constitutional defects.

[11] 361 U.S. at 385. As pointed out in footnote 6, here the United States is treated like the State of North Carolina, and unincorporated cities and towns but different from counties and incorporated cities and towns in North Carolina.

interested in this case, it is proper that we consider not merely the surface appearance of equality but also the ultimate effect produced by the whole state tax structure.[12] Given this approach, we find this case indistinguishable in principle from *Phillips*.

Nor do we think that the result in *United States v. Illinois Dep't of Revenue, supra* affords any solace to the defendant. Involved in that case was an Illinois statutory provision which imposed upon retailers a tax on receipts derived from the sale of tangible personal property in that state including sales to the federal government. However, the Illinois taxing act provided an exemption for retail sales to the state or its political subdivisions[13] and it was this exemption which was challenged as constitutionally improper. The state contended there (as the defendant contends here) that the tax would pass constitutional muster because the *statute* applied to all retailers, but this argument received short shrift from the court. The practical operation of the tax, the court declared, was what it was interested in, and that approach required consideration of the *effect* of the exemption provisions. Concluding that a retailer who dealt with the United States fell within the same class as one who dealt with the State of Illinois or its subordinate governmental units, the court held

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[12] 361 U.S. at 383, 191 F. Supp. at 728. *cf. Lawrence v. Mississippi State Tax Comm'n*, 286 U.S. 275, 280 (1922).

[13] An exemption was also provided for retail sales to organizations and institutions organized and operated exclusively for charitable, religious, or educational purposes. Although this exemption was discussed briefly in the first opinion, 191 F. Supp at 729, this language was later expressly withdrawn. 202 F. Supp. at 758. After the first judgment had been vacated "for further consideration in the light of the developments which have occurred since the injunction was issued," 368 U. S. 30, the exemption for sales to charitable, religious, and educational groups was challenged by the United States. In the second opinion, a divided three-judge court held that valid reasons supported the classification providing for an exemption on sales to the aforementioned nongovernmental groups while denying it on sales to governmental units, 202 F. Supp. at 759, and the Supreme Court affirmed. 371 U. S. 21. *Accord, People ex rel. Upland Coal Co. v. Isaacs*, 22 Ill. 2d 477, 176 N.E. 2d 889, — (1961).

There has been some discussion in the pleadings and in oral argument in this case of the fact that *N. C. Gen. Stat.* § 105-164.14(b) and 1 *CCH State Tax Rep.* (North Carolina) ¶ 60-206 authorize a tax refund to certain nongovernmental groups. We do not find it necessary to decide the constitutionality of that procedure in order to reach a conclusion in this case, and we express no opinion whatsoever upon it.

that the exemption in question was invalid because it was not available to all who were similarly situated and no reasonable basis for the difference in the treatment accorded the retailers was shown.[14] Although, as the defendant stresses, the initial judgment in this case was subsequently vacated by the Supreme Court (because, among other reasons, after the Illinois Supreme Court had also held the exemption section unconstitutional, the Illinois legislature amended the taxing statute to eliminate altogether an exemption on sales to any governmental unit), we find the court's reasoning and analysis on the federal constitutional question unassailable, and we adopt it here. Furthermore, we note that this decision has been followed in at least two recent state court cases in which state taxing provisions were declared unconstitutional because they resulted in discrimination against the United States. *Knapp-Stiles, Inc. v. Department of Revenue*, 370 Mich. 629, ... N.W. 2d ..... (1963); *Comptroller v. Pittsburgh-Des Moines Steel Co.*, 231 Md. 132, 189 A. 2d 107, *cert. denied*, 375 U.S. 821 (1963).

Having concluded that the statutory refund provision in question is unconstitutional because it discriminates invidiously against the United States, we turn to the relief which is appropriate in the circumstances of this case. In its motion for summary judgment, the plaintiff prayed that this court (1) hold the Act and regulations invalid insofar as they *impose* the taxes in controversy, (2) enter a permanent injunction against the further *assessment* and *collection* of the challenged taxes, and (3) declare that it is entitled as a matter of law to a refund of all taxes illegally collected since July 1, 1961, with the total amount of the refund to be determined at some future date at an evidentiary hearing held pursuant to an order of this court. In our judgment, however, the plaintiff's requests exceed the relief to which it is entitled.

The basis for overturning the refund provision is that it operates to place the federal government in a less advantage-

[14] "It is difficult for us to perceive a reasonable distinction which grants one (retailer) freedom from contributing to the cost of government and imposes the burden upon the other." 191 F. Supp. at 729.

ous position than that enjoyed by North Carolina counties and incorporated cities and towns. Were we to accede to the request that we act to prevent the *imposition* of the tax, however, we would not be requiring that North Carolina treat the plaintiff and her local governmental units in the same manner but we would in fact be placing the plaintiff in a more advantageous position than that occupied by the local governmental units. In short, we would be striking down one form of discrimination but by the same act creating another. All that the plaintiff can legitimately ask for in this case is that it be treated *the same as* the North Carolina counties and incorporated cities and towns. Therefore the United States, like everyone else, must resort to the refund procedure to recover what it is due. Accordingly, those (but only those) provisions of the Act and the regulations which operate to deny the United States a tax refund when an appropriate and timely request[15] therefor is made are hereby declared null and void. *Comptroller v. Pittisburgh-Des Moines Steel Co., supra* at 114.

The plaintiff is also entitled to recover the taxes paid since July 1, 1961, to which it would have been entitled had the North Carolina statute during that time read as we have today ruled that the United States Constitution requires that it read. The information before us, however, is not sufficient to permit us to enter an order specifying the amount of the refund to which the plaintiff is entitled. For the purpose of ascertaining the amount of the refund, a hearing is hereby authorized before Judge Butler.[16] 28 U.S.C.A. § 2284(5).

It is so ordered.

/s/ J. Spencer Bell
United States Circuit Judge

[15]Of course, in the circumstances of this case, the time limitation in the statute for refund applications will not bar recovery by the United States of the taxes in question collected by the defendant prior to this opinion.

[16]If the parties are able to agree among themselves upon the refund figure to which the plaintiff is entitled, they may stipulate the amount before Judge Butler, and then no hearing would be necessary.

/s/ Algernon Butler
United States District Judge

/s/ J. B. Craven, Jr.
United States District Judge

September 15, 1965.

Appendix B

STATE OF NORTH CAROLINA
DEPARTMENT OF REVENUE
RALEIGH

W. A. Johnson
Commissioner

March 8, 1963

Major Richard G. Garties, JAGC
Acting Chief, Property & Tax Law Branch
Procurement Law Division
Department of the Army
Office of the Judge Advocate General
Washington 25, D. C.

Dear Major Garties:

We have now completed our study in consideration of your refund claim filed with us on December 18, 1962.

We have concluded that under the applicable statutory provisions we are without authority to allow your refund claim and the same is therefore respectfully denied.

With best wishes, I am

Very truly yours,
W. A. Johnson

WAJ/mj

cc: Mr. Eric L. Gooch, Director
Sales & Use Tax Division

Appendix C

STATE OF NORTH CAROLINA
DEPARTMENT OF REVENUE
RALEIGH

SALES AND USE TAX REGULATION 6
SUBJECT: BUILDING MATERIALS

(a) All building materials, supplies, fixtures and equipment of every kind and description which become a part of or are annexed to any building or other structure are subject to the 3% sales or use tax. Vendors of such items are required to register and to collect and remit the tax on their sales to contractors and other users or consumers.

(b) If the contractor purchases from a vendor outside the State any building materials, supplies, fixtures or equipment for use in the construction, erection, alteration or repair of a building or other structure in this State and the vendor does not collect the tax thereon, such contractor must remit the use tax directly to the Department. The Sales and Use Tax Law provides that in such cases the tax is a joint liability of the contractor and the owner. The liability of the owner will be satisfied if he obtains from the contractor before settlement an affidavit that the tax due has been paid.

NOTE: Contractors and "retailer-contractors" should refer to Sales and Use Tax Regulation 10.

NOTE: The foregoing is a true copy of Sales and Use Tax Regulation 6, which Regulation was promulgated by the Commissioner of Revenue, approved by the Tax Review Board, and filed in the office of the Secretary of State, as required by G.S. 105-164.43. Said Regulation became effective May 14, 1962.

Appendix D

STATE OF NORTH CAROLINA
DEPARTMENT OF REVENUE
RALEIGH

Amended 7-1-65

SALES AND USE TAX REGULATION 42
SUBJECT: SALES TO OR BY THE STATE, COUNTIES, CITIES, AND OTHER POLITICAL SUBDIVISIONS AND AGENCIES OF THE STATE OR ANY LOCAL GOVERNMENTAL UNIT.

(a) Sales of tangible personal property not specifically exempt by statute to the State of North Carolina, counties, cities, towns ,and political subdivisions or any agencies thereof for the purpose of use or consumption are subject to the sales or use tax. Sales of building materials, supplies, fixtures and equipment to contractors for use in the performance of contracts with any above referred to governmental units or agencies are likewise subject to the sales or use tax.

(b) When any governmental unit or agency referred to in this Regulation makes taxable purchases of tangible personal property from a North Carolina supplier or a registered out-of-state supplier who charges the North Carolina sales or use tax thereon, such governmental unit or agency must remit the tax on such purchases to the supplier. Any such governmental unit or agency making taxable purchases of tangible personal property from an out-of-state supplier who does not collect the North Carolina sales or use tax thereon is required to register with the Department and remit monthly the tax due on such purchases. Any governmental unit or agency so required to register which does not owe any tax for a given month should file a report reflecting "no tax due."

(c) If any governmental unit or agency referred to in this Regulation makes taxable retail sales of tangible personal property, it must register with the Department and collect

and remit the tax due on such sales. *The refund provisions contained in this Regulation do not apply to the tax on such sales and no part thereof shall be refunded or claimed as a refund.* Governmental units and agencies properly registered for sales and use tax purposes may purchase the tangible personal property which they resell without paying tax thereon to their suppliers *provided* they have furnished such suppliers with properly executed Certificates of Resale, Form E-590.

(d) Certificates of Resale *may not be used* by any governmental unit or agency herein referred to, or by any other vendee, in making purchases of tangible personal property to be used or consumed by such purchaser.

(e) Counties and incorporated cities and towns and sanitary districts are entitled to an annual refund of sales and/or use taxes paid by them on their direct purchases of tangible personal property, subject to the terms and conditions herein set forth. *The refund provisions do not apply to the State of North Carolina, nor to any bodies, agencies or political subdivisions thereof other than counties and incorporated cities and towns and sanitary districts in this State.*

(f) For refund purposes, purchases by contractors of building materials, supplies, fixtures and equipment which become a part of or are annexed to any building or structure being erected, altered, or repaired under contract with any county or incorporated city or town or any sanitary district are deemed to be direct purchases.

(g) Refund claims of counties and incorporated cities and towns and sanitary districts must be filed with the North Carolina Department of Revenue within six (6) months after the close of the fiscal year of the claimant. *The Statute prohibits the payment of any refund claim not filed within the stipulated time.*

All refund claims must be substantiated by proper doc-

umentary proof and only those taxes actually paid by the claimant during the fiscal year covered by the refund claim may be included in the claim.

As to taxes paid on purchases for use, other than those made by contractors performing work for the claimant, invoices or copies of invoices showing the property purchased, the cost thereof, the date of purchase, the amount of sales or use tax paid thereon and a record reflecting the date of payment will constitute proper documentary proof.

To substantiate a refund claim for sales or use taxes paid on purchases of building materials, supplies, fixtures and equipment by its contractor, the claimant must secure from such contractor certified statements setting forth the cost of the property purchased from each vendor and the amount of sales and/or use taxes paid thereon. In the event the contractor makes several purchases from the same vendor, such certified statement must indicate the invoice numbers, the inclusive dates of the invoices, the total amount of the invoices and the sales and use taxes paid thereon. Such statement must also include the cost of any tangible personal property withdrawn from the contractor's warehouse stock and the amount of sales or use tax paid thereon by the contractor. Similar certified statements by his subcontractors must be obtained by the general contractor and furnished to the claimant.

NOTE: The foregoing is a true copy of Sales and Use Tax Regulation 42, as amended and promulgated by the Commissioner of Revenue, approved by the Tax Review Board, and filed in the office of the Secretary of State, as required by G.S. 105-164.43. Said Regulation became effective May 14, 1962, and the amendments thereto became effective July 1, 1965.

Appendix E

STATE OF NORTH CAROLINA
DEPARTMENT OF REVENUE
RALEIGH

SALES AND USE TAX REGULATION 48
SUBJECT: SALES TO THE UNITED STATES GOVERNMENT OR AGENCIES THEREOF

(a) Sales made directly to the United States Government, or any agency thereof, are not subject to the sales or use tax. In order to be a sale to the United States Government, the Government or agency involved must make the purchase of the property, obtain title to the property before or at the time it is delivered, and pay directly to the vendor the purchase price of such property.

Nontaxable Federal Agencies include the United States Post Office, War and Navy Departments, United States Hospitals, Federal Reserve Banks, Federal Land Banks, Federal Housing Projects, Federal Housing Authorities, National Banks, or any other department or departments of the Federal Government whose activities are directly under Federal control and whose purchases are paid for from the Federal Treasury.

Sales made to Army, Navy and Air Force Activities Funds, Post Exchanges, Officers' Mess Funds, Non-commissioned Officers' Funds and other voluntary unincorporated organizations of Army, Navy, Marine Corps, or Coast Guard personnel authorized by regulations issued by the War Department or Navy Department are likewise exempt from sales and use tax.

(b) A vendor making sales directly to the United States, or any agency thereof, must obtain purchase requisitions or affidavits signed by the purchasing officer stating that such sales are being made to one of the organizations or activities listed above. Such purchase requisitions or affidavits must

be retained by the vendor in his files for three years following the date of sale and must be available for inspection by the Commissioner or his agents upon request.

(c) Sales of tangible personal property to contractors for use in performing contracts with the United States Government or its agencies and instrumentalities are subject to the 3% sales or use tax.

NOTE: The foregoing is a true copy of Sales and Use Tax Regulation 48, which Regulation was promulgated by the Commissioner of Revenue, approved by the Tax Review Board, and filed in the office of the Secretary of State, as required by G.S. 105-164.43. Said Regulation became effective May 14, 1962.

CERTIFICATE OF SERVICE

This is to certify that the foregoing Jurisdictional Statement was this day served upon the plaintiff in this action by personally delivering to the office of the United States Attorney, Post Office Building, Raleigh, North Carolina, a copy of the Jurisdictional Statement.

This 6th day of January, 1966.

Peyton B. Abbott
Deputy Attorney General of the
State of North Carolina